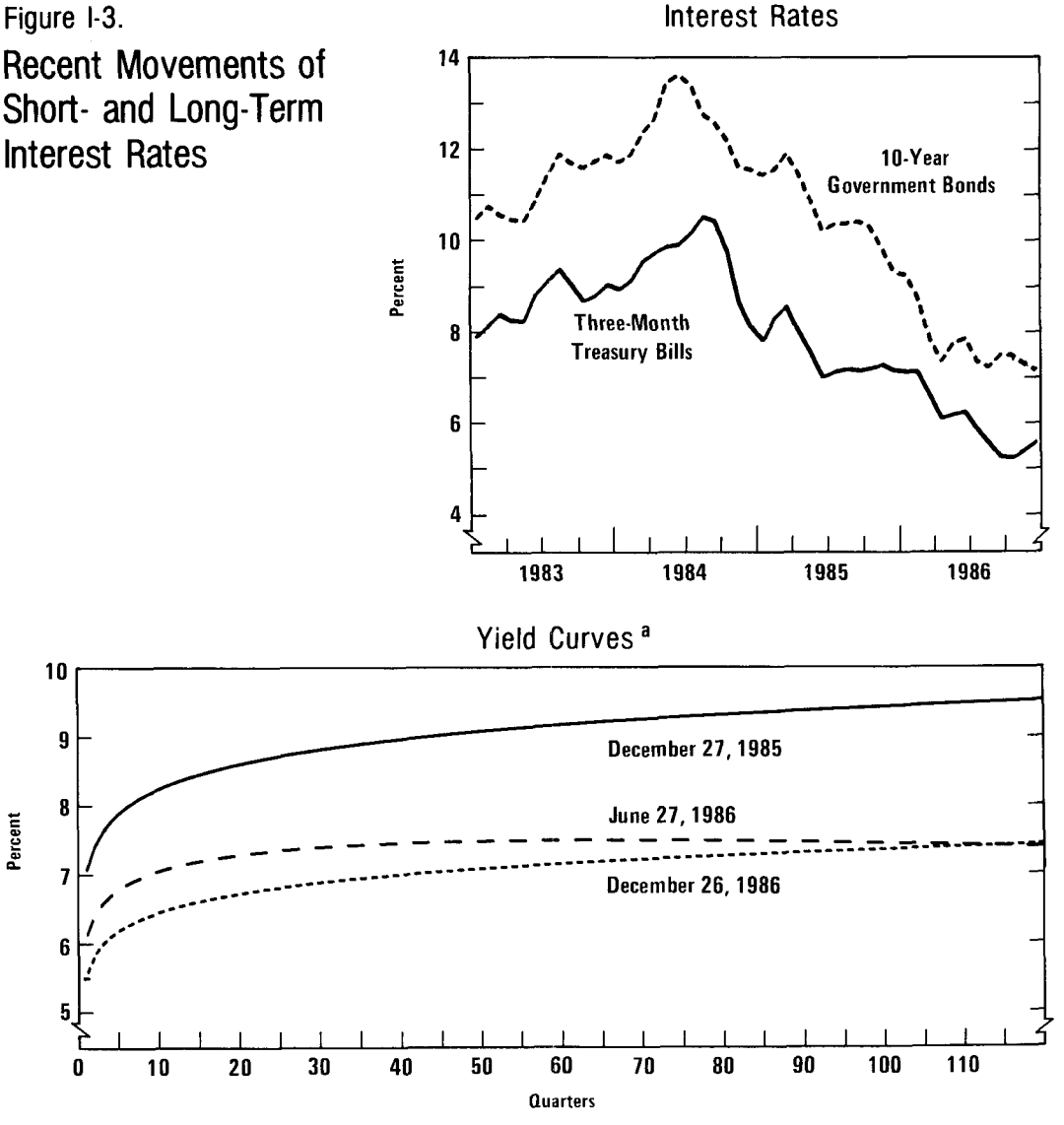
part. The Standard and Poor's Index of 500 Stocks rose over 40 percent from December through June, and then slowed to a still respectable 6 percent growth in the second half (see Figure I-5).

Monetary Policy. Judged on the basis of the broader monetary aggregates, various reserve measures, and money market indicators, Federal Reserve

Figure I-3.

Recent Movements of Short- and Long-Term Interest Rates



SOURCES: Congressional Budget Office; Federal Reserve Board.

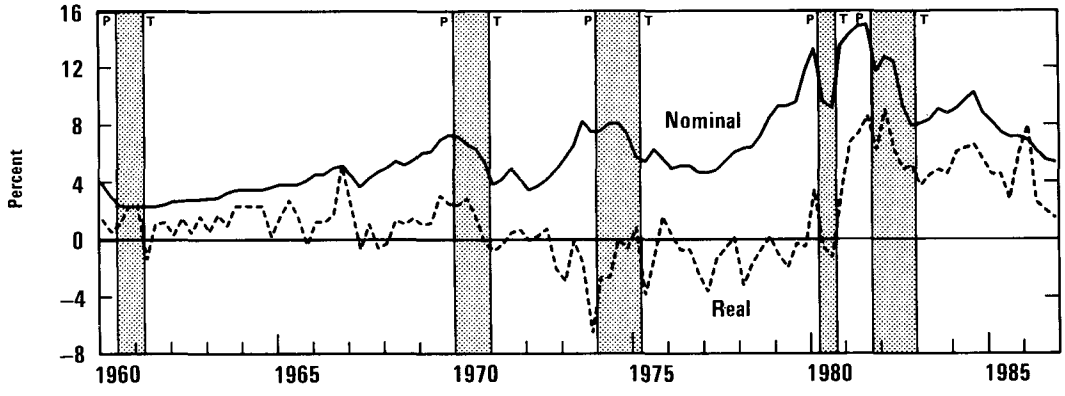
[a]These curves were fitted to weekly average yields on Treasury instruments using a logarithmic function described by Bradley and Crane in the *Journal of Bank Research*, Spring 1973.

policy was accommodative in 1986. The growth of M1 was dramatic, as shown in Figure I-6. From November 1985 to November 1986, M1 grew by 15 percent, far above the 8 percent upper bound of the Federal Reserve's target range. In contrast, both the M2 and M3 measures were close to the upper bounds of their target ranges. Total domestic nonfinancial debt grew about 13 percent last year, slightly above its upper target of 11 percent.

The reserve aggregates tell a similar story of monetary accommodation (see Table I-6). The monetary base expanded at a rate of 9 percent to 10 percent over the entire year, and total reserves exploded at a rate above 20 percent. Adjustment plus seasonal borrowing from the discount window--a measure of the reserve pressures on commercial banks--remained relatively steady between $300 million and $400 million, and the spread between the federal funds rate and the discount rate hovered in a very narrow range throughout most of the year. Both of these measures indicate a policy of monetary ease. The Federal Reserve underscored its accommodative policy with four reductions in the discount rate of one-half of a percentage point each.

Last July, the Federal Reserve Board announced tentative targets for the broader monetary aggregates for 1987. The targets for the growth of M2 and M3 were cut one-half of a percent to a range of 5½ percent to

Figure I-4.
Nominal and Real Three-Month Treasury Bill Rates



SOURCES: Congressional Budget Office; Federal Reserve Board; Department of Commerce, Bureau of Economic Analysis.

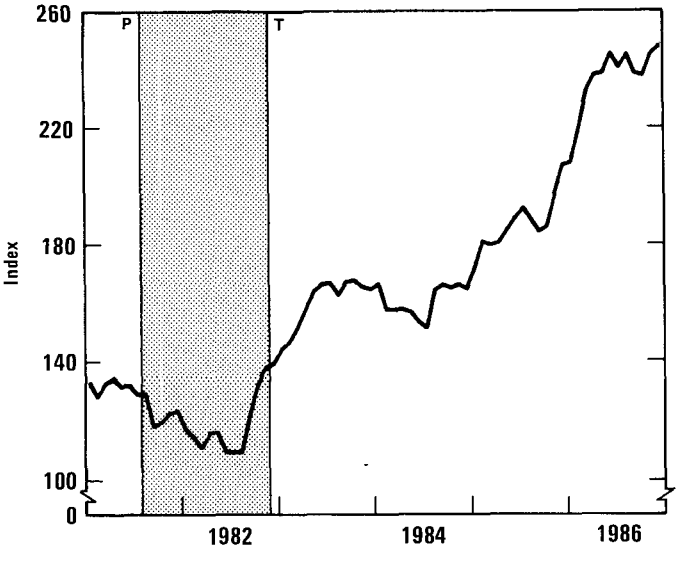
NOTE: The real three-month Treasury bill rate used here is a nominal rate minus the next quarter's rate of change in the implicit price deflator. The 1986:IV value for the real interest rate is based on the CBO forecast of the personal consumption deflator for 1987:I.

8½ percent, and the target growth of debt was left between 8 percent and 11 percent. At the same time, the Federal Reserve said that the 1986 target range for M1 of 3 percent to 8 percent would be indicative of the 1987 target range if the velocity of M1 stabilized. The Federal Reserve qualified this range, however, citing the exceptional uncertainties in predicting the behavior of M1, and said it would review the appropriate range and weight to be placed on this aggregate.

The measures of the velocity of money (that is, the ratios of nominal GNP to each of the monetary aggregates) have departed substantially from long-run trends in recent years (see Figure I-7). The departure was particularly severe for the velocity of M1, but the velocities of M2 and M3 have also deviated from trend. Various hypotheses have been offered to explain these deviations, but none is entirely satisfactory. The phenomenon is not well understood.

Under these conditions, the management of monetary policy is fraught with risks. The difficulty of forecasting various velocities means it will be equally difficult to choose appropriate targets of growth for the monetary aggregates. The target ranges have sufficient leeway to allow for gradual adjustment to changes in velocity trends, but a surprising shift in velocity may not be recognized for a long time. If the ratio between nominal GNP and the monetary aggregates suddenly rises--that is, if velocity increases--expected inflation may increase, further reducing the desire to hold money, and further increasing velocity. Similarly, a downward shift in velocity may raise fears of a recession and may further reduce velocity. The possibility

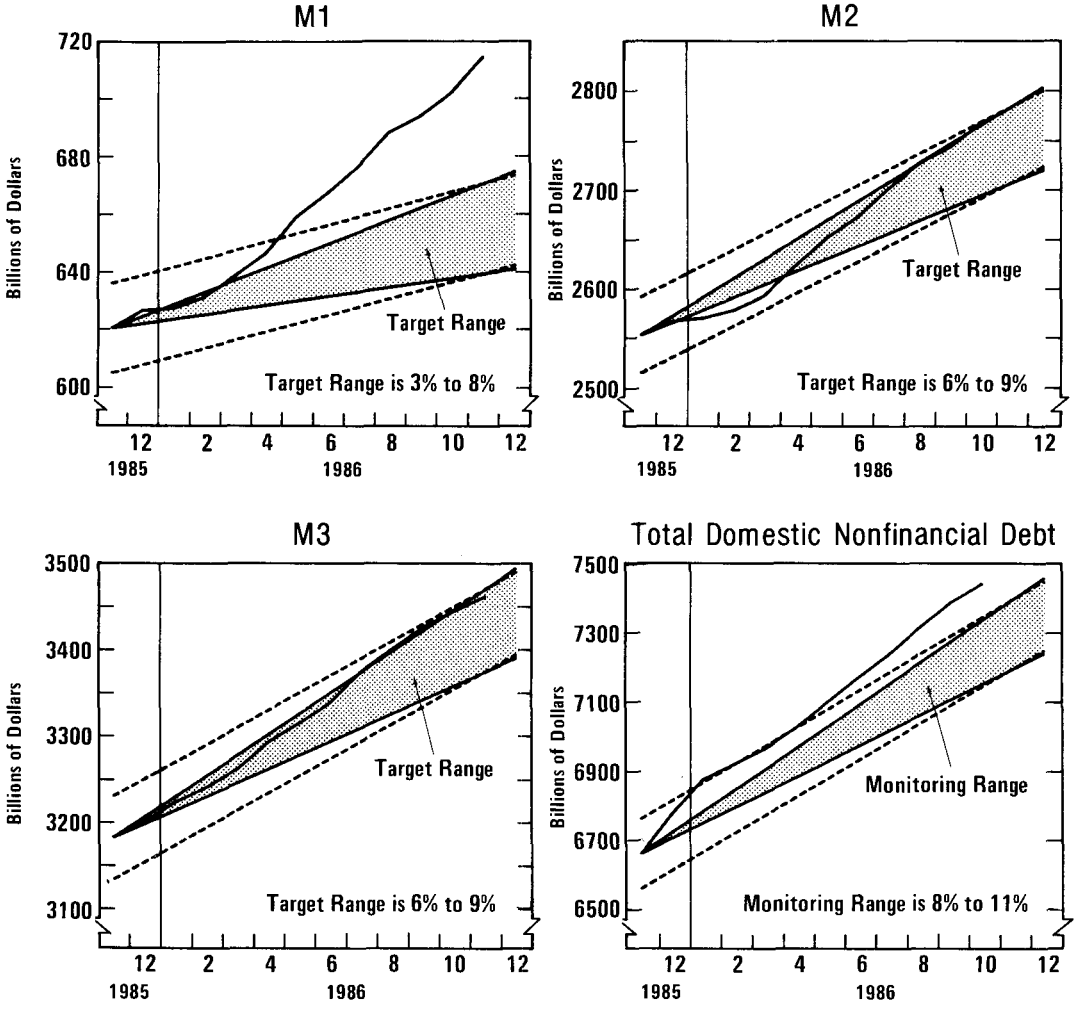
Figure I-5.
Common Stock Prices (Standard and Poor's "500")



SOURCES: Congressional Budget Office; Standard and Poor's Corporation.

of such instability complicates the management of monetary policy. The Federal Reserve has been able to accommodate the shifts in velocity that have occurred, while minimizing the adverse effects on the economy. The CBO forecast expects this situation to continue, but the possibility that it will not continue represents an element of uncertainty in the forecast.

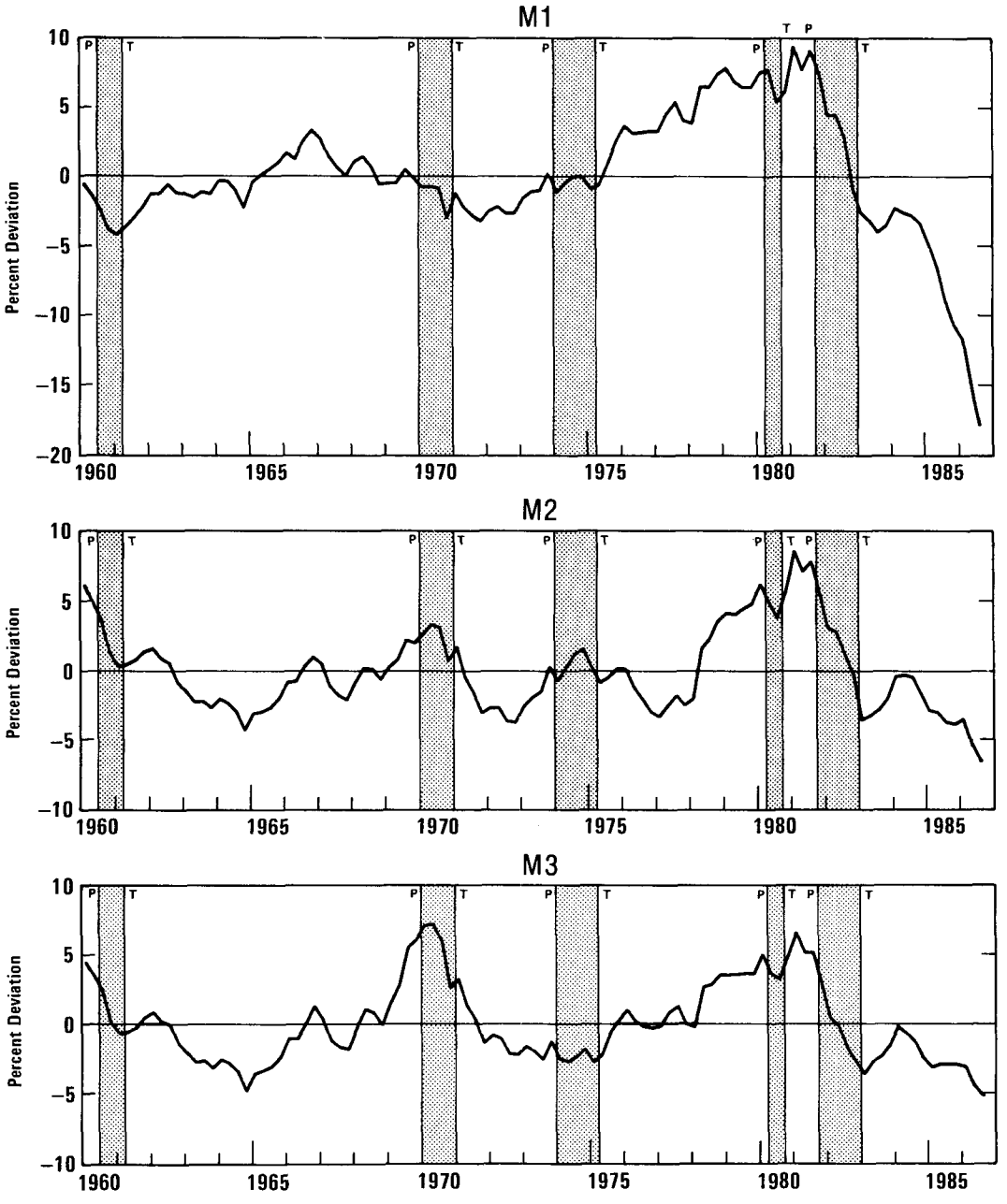
Figure I-6.
Money Growth and Targets in 1986



SOURCES: Congressional Budget Office; Federal Reserve Board.

NOTE: Dotted lines refer to growth bands that the Federal Reserve Board considers consistent with its targets.

Figure I-7.
Velocity: Deviations from Trend Level



SOURCES: Congressional Budget Office; Federal Reserve Board; Department of Commerce, Bureau of Economic Analysis.

NOTE: Velocity is the ratio of GNP to money.

RECENT ECONOMIC DEVELOPMENTS

The growth of the economy over the four quarters of 1986 was about the same as in 1985, despite sharp declines in interest rates, oil prices, and the value of the dollar early in the year. Industrial production worsened in the first half of the year as oil extraction slumped and net exports deteriorated, but by the end of the year it had strengthened. Employment made strong gains but not enough to reduce the unemployment rate significantly. Moreover, though the fall in oil and other commodity prices caused the inflation rate to decline temporarily, the inflation rate at year-end was not significantly different from what it was in late 1985.

Aggregate Economic Activity

The success of foreign producers in competing with U.S. firms in U.S. and overseas markets continued to drive a wedge between domestic demand and the growth of output in the first three quarters of 1986 (see Figure I-8). The growth of total domestic final demand slowed, but the growth of output slowed even more (see Table I-7).

Industrial production declined in the first half of the year, and rates of industrial capacity utilization fell from almost 81 percent in December 1985

TABLE I-6. SELECTED MEASURES OF MONETARY POLICY
(Seasonally adjusted annual rates of change, in percents, unless otherwise noted)

Time Period	Growth in Monetary Base	Growth in Total Reserves	Seasonal and Adjustment Borrowing (millions of dollars) a/	Spread Between Federal Funds and Discount Rates (percentage points) a/
1986: I	8.9	13.8	303	0.46
1986: II	9.1	19.0	276	0.31
1986: III	10.2	24.9	405	0.38
1986: IV	11.1	26.6	401	0.77

SOURCES: Congressional Budget Office; Federal Reserve Board.

a. Not seasonally adjusted.

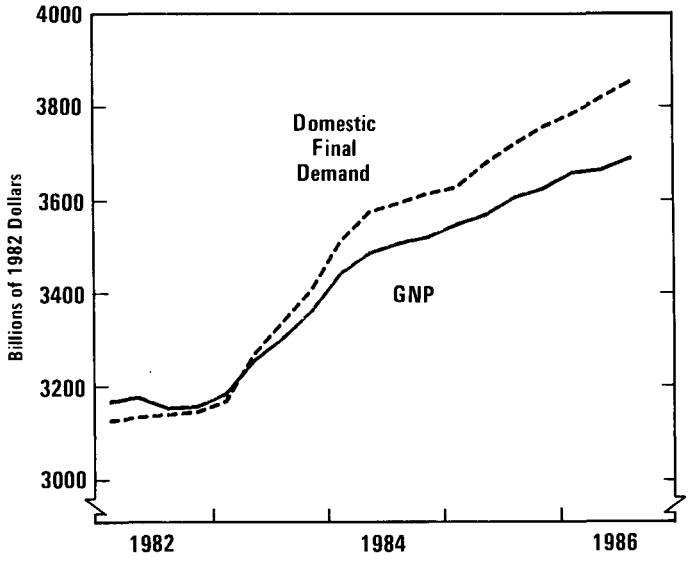
to 79 percent by mid-1986. Manufacturing of durables turned in a particularly weak performance as net exports of those goods deteriorated. Although some industries managed gains in the first half of the year, most declined, and from December 1985 to June 1986 the Industrial Production Index fell 2.2 percent. In the second half of the year, however, the Industrial Production Index grew by more than 3 percent. Much of the turnaround resulted from an increase in the production of defense and space equipment and a leveling off of the previous declines in mining and utilities. A wide range of industries, however, experienced significant rebounds in production rates.

Labor Markets

The unemployment rate showed little change last year as the growth in the labor force--with a record-high participation rate--almost kept pace with the creation of jobs. Manufacturing employment recovered slightly at year-end after falling most of the year, but virtually all of the growth in employment was in the service-producing sector. Growth in productivity for the economy as a whole was poor, despite the good productivity performance in the manufacturing sector.

Unemployment and Employment. The unemployment rate for civilian workers has shown a moderate downward trend since late 1985. In the fourth quarter of 1986, the rate was 6.8 percent, slightly below that of the

Figure I-8.
Gross National Product and Domestic Final Demand



SOURCES: Congressional Budget Office; Department of Commerce, Bureau of Economic Analysis.

last quarter of 1985. The unemployment rate for adults has changed little since late 1985. The rate for teenagers, however, has eased by about a percentage point, and the unemployment rate for blacks also fell, largely because of a reduction in the unemployment rate for teenagers.

Although the unemployment rate showed almost no change, many new jobs were created. The household survey conducted by the Bureau of Labor Statistics indicates that employment grew by about 2.3 percent between the

TABLE I-7. REAL GNP AND INDUSTRIAL PRODUCTION
(Percent change from previous period at annual rates, unless otherwise noted)

Economic Indicator	1984	1985	1986 I	1986 II	1986 III
Real GNP	6.4	2.7	3.8	0.6	2.8
Final sales	4.4	4.2	-1.3	3.4	4.5
Personal consumption	4.7	3.5	3.6	6.2	6.7
Business fixed investment	16.9	9.3	-15.1	-0.9	-2.1
Residential investment	14.3	3.9	11.0	14.5	9.7
Government purchases	4.0	6.8	-12.3	9.7	4.5
Exports	6.2	-2.0	7.1	-9.8	13.3
Imports	23.1	3.8	0.2	15.8	17.3
Inventory Change (billions of 1982 dollars)	59.2	9.0	39.9	15.1	-0.3
Net Exports (billions of 1982 dollars)	-83.6	-108.2	-125.9	-153.9	-163.3
Real Final Sales to Domestic Purchasers a/	6.3	4.8	-1.8	6.4	5.3
Industrial Production	11.2	2.0	1.0	-1.9	1.9
Consumer durables	13.9	0.6	2.4	-1.0	6.4
Business equipment	16.3	4.2	0.6	-6.1	3.5
Defense and space	9.3	9.1	0.7	2.3	6.2

SOURCES: Congressional Budget Office; Department of Commerce, Bureau of Economic Analysis; Federal Reserve Board.

a. Real final sales minus net exports.

fourth quarters of 1985 and 1986. By comparison, employment grew by 1.9 percent between the fourth quarters of 1984 and 1985.

The service-producing sector has accounted for about 85 percent of all new nonfarm jobs since the trough of the last recession (November 1982), and for all of the increase in employment since late 1985. In fact, of the 2.1 million nonfarm, private-sector jobs created last year, about 75 percent were in four specific service categories: retail trade, business services, health services, and the finance, insurance, and real estate sector.

Employment in manufacturing, on the other hand, declined from February to September 1986 before showing some signs of recovery late in the year. Mining employment, which constitutes only a small fraction of total employment, fell sharply through most of the year, and construction jobs grew rapidly before leveling off in October.

Productivity and Unit Labor Costs. Growth in productivity has been poor for the economy as a whole, but the manufacturing sector has experienced solid gains. Between the third quarters of 1985 and 1986, real manufacturing output grew by 2.0 percent while manhours fell by 0.3 percent, resulting in a 2.3 percent increase in productivity in that period.

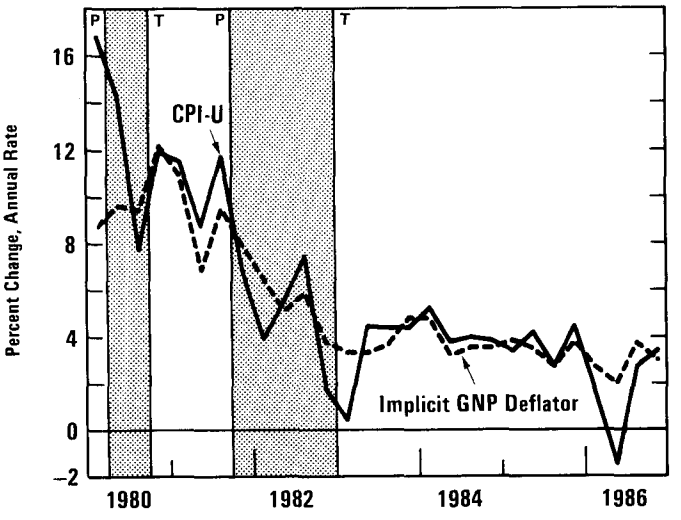
Output per hour for the total nonfarm business economy (which includes manufacturing) grew by only 0.3 percent over the year ending in the third quarter of 1986. Unit labor costs rose by 2.5 percent, despite modest growth in wages.

In manufacturing, however, the combination of solid gains in productivity and small increases in nominal hourly compensation caused unit labor costs to rise by only 0.2 percent in the four quarters ending in the third quarter of 1986. In the last two years, unit labor costs in manufacturing have been increasing at only about 0.5 percent per year. The small increase in unit labor costs over the past year should help to improve the trade balance in manufacturing.

Inflation

The inflation picture is still dominated by recent movements in the prices of oil and food. In the first half of 1986, the dramatic fall in oil prices from nearly $30 a barrel late last year to the low teens, combined with low meat prices caused in part by government incentives to slaughter dairy cows, led to several months of declines in the Consumer Price Index. This situation was unusual and unsustainable. In fact, the increase in oil prices from

Figure I-9.
Recent Inflation Rates



SOURCES: Congressional Budget Office; Department of Commerce, Bureau of Economic Analysis; Department of Labor, Bureau of Labor Statistics.

NOTE: Data for the fourth quarter of 1986 are estimated by CBO.

around $12 to around $15 a barrel that occurred in the second half of 1986, combined with higher growth of food prices (mainly meats) in the same period, pushed the rate of increase in the CPI in the second half of 1986 back to its recent trend (see Figure I-9).

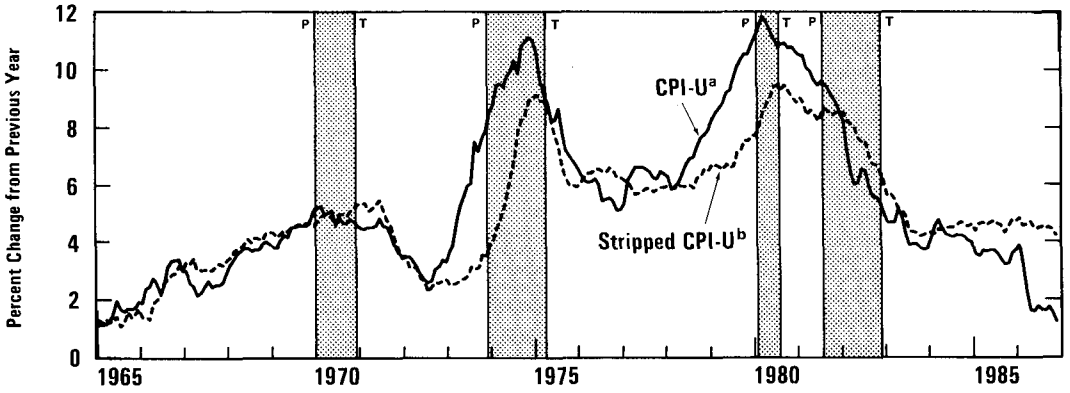
If one looks beyond these special factors, the striking fact is the stability in the rate of increase in the "stripped" CPI. 8/ For the past three years, the 12-month change in the stripped CPI has not deviated by more than a few tenths of a percentage point from 4½ percent (see Figure I-10). Two partly offsetting factors contributed to this stability:

- The rate of wage increases fell dramatically in 1986, resulting in a virtual elimination of cost pressures stemming from this source;
- The falling value of the dollar since early 1985, however, has recently caused prices of imported goods (even excluding oil) to increase quite sharply.

Assessing the magnitude of these influences on inflation is complicated by severe measurement problems. The decline in wages is probably over-

8. CPI for all urban consumers, excluding food at home, energy, and used cars.

Figure I-10.
Measures of Inflation



SOURCES: Congressional Budget Office; Department of Labor, Bureau of Labor Statistics.

[a] CPI-U from January 1983 to present; before that time, a CPI measure that is conceptually similar to the current CPI-U treatment of homeownership.

[b] CPI-U excluding food, energy, and used cars.

stated for the nonmanufacturing sectors, while the most common measures of the exchange rate overstate both the magnitude of the increase in the dollar from 1980 to 1985 and the extent of its decline since early 1985. The problems associated with the measurement of exchange rates are discussed in the section on net exports; the problems concerning the measurement of wages are discussed below.

Wages. The overall rate of increase in nominal wages has fallen drastically since 1980. As measured by the average hourly earnings index (AHEI), it fell to a 2.3 percent rate of growth in 1986 (see Figure I-11). The AHEI probably understates wage growth, however, because it fails to take account of employment shifts within industries such as wholesale trade, retail trade, and construction, and, to a much lesser extent, of occupational shifts in manufacturing. Components of the employment cost index (ECI), plotted with the corresponding components of the AHEI in Figure I-12, are constructed by a procedure that holds constant not only the industrial composition of employment at quite a fine level of detail, but also the gross occupational composition. The fact that the AHEI is lower than the ECI implies that, within each industrial sector, the composition of employment has shifted toward lower-paying jobs. 9/ Therefore, the rate of increase in

9. The ECI indexes are generally more volatile than the AHEI indexes because they are based on a smaller sample of observations. This difference in volatility does not, however, appear to reduce the force of the arguments presented here.

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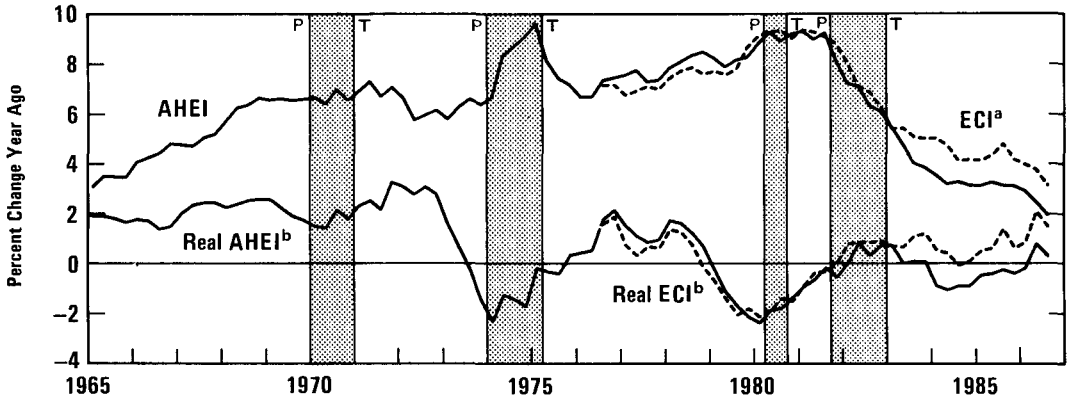
nominal wages in 1986 is probably best measured by the ECI, which grew by 3.1 percent between the third quarters of 1985 and 1986. This growth is still quite low by historical standards, however. Two factors--strong foreign competition and chronic excess capacity--have contributed to the weak growth in wages.

- The dollar, despite its recent fall, is worth considerably more relative to foreign currencies than it was in 1980. Because of this higher value, American labor competes with overseas labor that, in dollar terms, is cheaper relative to American labor than it was in 1980. This competition increases both imports and the possibility that U.S. companies might move their manufacturing facilities overseas. As a result, wages in the United States are held down.

- Excess capacity is holding down both wages and prices. The unemployment rate has remained stubbornly around 7 percent for nearly two years. Many economists think that higher wage growth will occur only when the rate drops toward 6 percent. Capacity utilization in manufacturing has also remained relatively low and has not changed much for two years.

Figure I-11.
Private Nonfarm Wages



SOURCES: Congressional Budget Office; Department of Labor, Bureau of Labor Statistics.

NOTE: AHEI = average hourly earnings index, ECI = employment cost index.

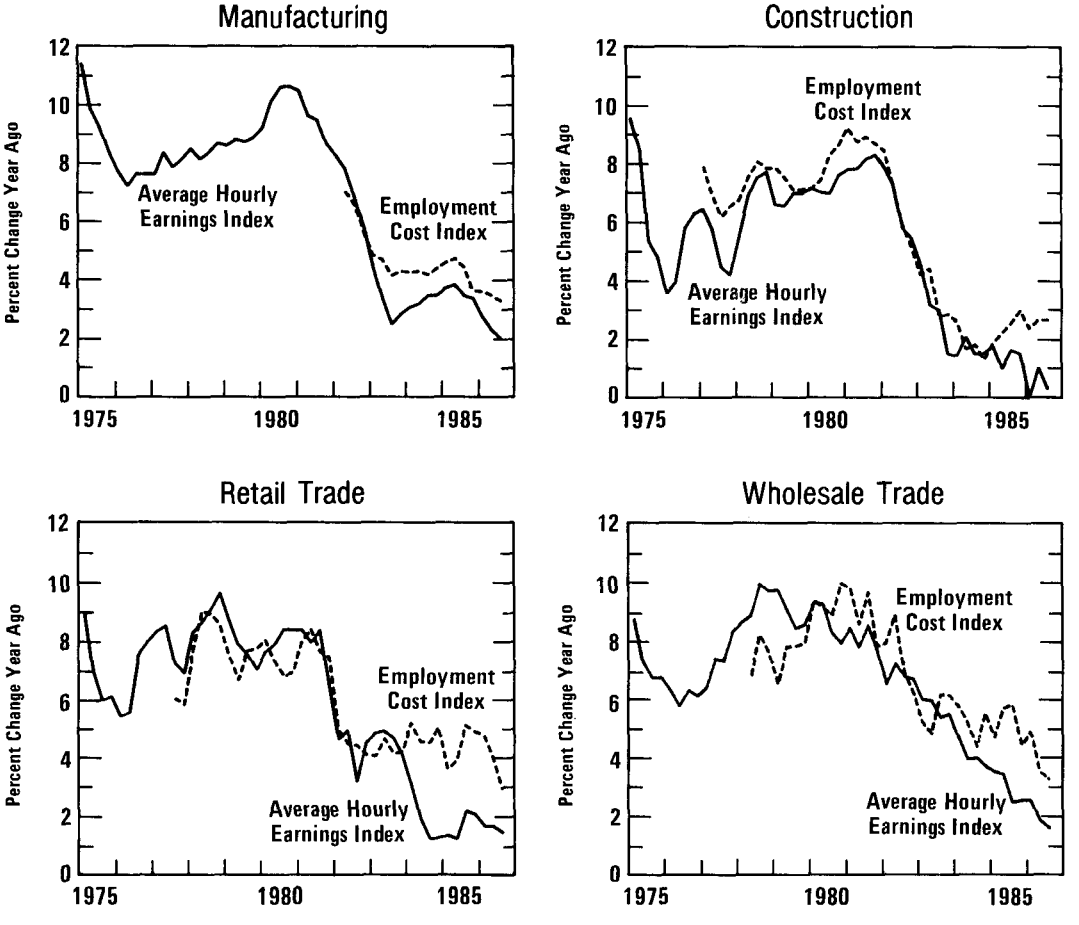
[a]Wages and salaries.

[b]Nominal index deflated by a version of the CPI-U that treats homeownership consistently.

Low-wage occupations can be expected, broadly speaking, to have low productivity as well. Thus, these shifts in employment probably contribute to the poor productivity performance of recent years (Chapter III pursues this point further). They also help to explain why, despite rapid growth in employment, the aggregate of labor incomes has increased relatively slowly in the current expansion.

Outlook for Oil Prices. The Organization of Petroleum Exporting Countries (OPEC) met in December to arrange a new system of official prices and

Figure I-12.
Occupational Shifts and Wages



SOURCES: Congressional Budget Office; Department of Labor, Bureau of Labor Statistics.

NOTE: The average hourly earnings index is affected by employment shifts to low-wage occupations, while the employment cost index is not. Thus the difference between the indexes is a measure of the effects of occupational shifts on wages.

production quotas intended to enforce a price structure equivalent to about $18 a barrel for marker crude oil. OPEC appears to have been reconsolidated for the time being under Iranian leadership with tacit Saudi approval. Although an agreement was reached, like previous agreements it will be hard to enforce:

- After 18 months, OPEC returned to a procedure that specifies both prices and quantities for exports of the OPEC member countries. Only by chance will the price differentials and quantities specified by the agreement be consistent with market demands. Where differentials are distorted, exporters will be under considerable pressure to discount prices.

- The OPEC agreement did not include Iraq, and Iraq could increase its output significantly in the near future.

The agreement did not eliminate OPEC's fundamental problems--the slackening of world oil demand in the mid-1980s brought on by sluggish GNP growth and the response to earlier price increases, and the rapid growth of non-OPEC sources of supply. Because of these problems, it seems unlikely that OPEC will seek official prices higher than $18 in the near future. High current inventories of oil and related products could also force down prices. Thus, prices are much more likely to drop below $18 per barrel than rise above that price in the next year or so. CBO's forecast, completed before the OPEC meetings, assumes that oil prices will remain close to $15 per barrel through 1988. This forecast is in line with market expectations before the OPEC meeting, but it implies lower prices than the market currently assumes. 10/

Outlook for Inflation. Inflation, as measured by the CPI, will probably accelerate somewhat in the next year because of the increase in import prices resulting from the recent and projected decline in the exchange rate, and because of the projected increase in oil prices from about $12 to about $15 a barrel between mid-1986 and early 1987. If oil prices are higher than assumed by CBO, the CBO forecast will have understated the contribution of energy prices to inflation. The GNP deflator is also expected to show an increase in inflation, though it will be smaller than the increase in CPI inflation. Some of the same factors may spur an upturn in the rate of increase of wages.

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10. At the time of writing, spot and forward prices are above $18, reflecting the abnormally cold winter in Europe that is incompletely offset by good weather in the United States.

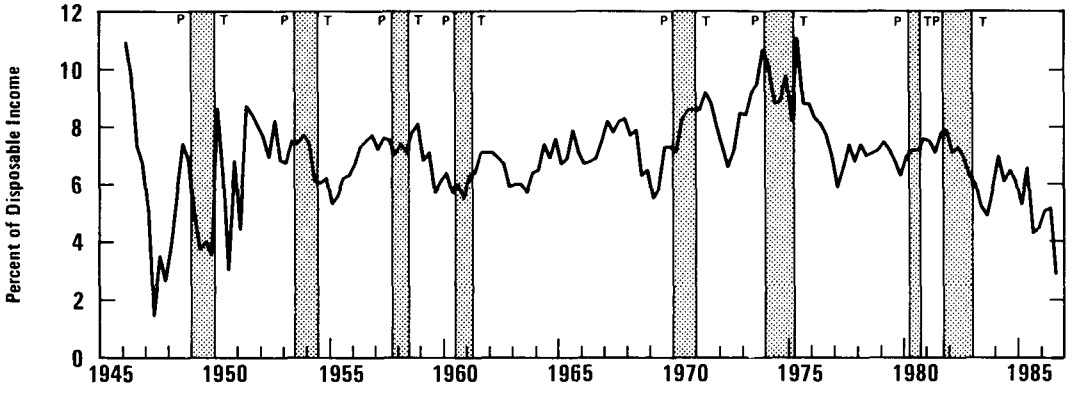
Consumption

Vigorous consumer demand has been a major source of economic growth over the past three years. By the end of 1985, after three years of recovery, real consumer spending had grown 4.2 percent over its level at the fourth-quarter recession trough in 1982. The average for the seven previous recoveries at the same stage is 3.9 percent. The rapid growth in total consumer spending was attributable to the category of durable goods which, through 1985, grew an average of 9.8 percent--well above the postwar-recovery average of 6.6 percent.

Despite the unusually strong growth of consumption by the end of 1985, it continued to outpace overall economic growth in the first three quarters of 1986. Many analysts argue that the rapid growth in consumption to date has depended too heavily on debt-financed purchases of durable goods without solid underlying growth in real disposable income. The low personal saving rate, one of the lowest since World War II, attests to this imbalance between income and outlays (see Figure I-13).

On the other hand, many economists argue that the increase in household net worth in recent quarters provides a strong basis for the rapid growth in consumption. They point out that despite record-high ratios of consumer installment debt to income (over 19 percent), which some analysts view as a sign of stressed consumer balance sheets, the real value of household assets has increased substantially since 1985. This rise is the result of the marked decline in interest rates, the stock market boom, and

Figure I-13.
Personal Saving Rate



SOURCES: Congressional Budget Office; Department of Commerce, Bureau of Economic Analysis.

rising home values. The net effect of these developments has been to improve the real net worth of households. The pace of accumulation of net worth over the near term may be tempered by less favorable movements in the stock market, stable interest rates, and, possibly, some features of the new tax law. Still, the gains since 1985 are not expected to be reversed.

There are a number of indications that the short-term outlook for consumption of durable goods is not good. Data on consumption have shown considerable volatility in recent months, but the rate of increase of real expenditures appears to have fallen off in the last quarter of 1986. The growth of furniture and appliance sales is likely to slow this year since such sales have probably not yet fully reflected the mid-1986 downturn in housing starts. In addition, auto sales may fall early this year. Because the new tax law eliminated the deductibility of sales taxes from taxable personal income as of January 1987, consumers may have made purchases in 1986 that they would normally have made in 1987. These signals point to an abatement in 1987 of this recovery's exceptionally rapid growth in real expenditures on durable goods.

Although the short-term signals indicate a slowing of growth, the extent of the slowdown depends on the more fundamental factors that determine consumer demand. In the recovery to date, growth in personal disposable income--held back by the high rate of unemployment and slow growth in labor income--has not been exceptional. The Tax Reform Act of 1986 may increase disposable income and therefore raise consumer spending, but it is also possible that the increase in the effective tax rate on corporations will result in higher prices, lower wages, or lower dividends. All of these factors would weaken the stimulus of the tax law on real disposable income. CBO anticipates that the rate of growth of all categories of consumption will slow in 1987.

Business Fixed Investment

Business fixed investment was soft in 1986, and the near-term outlook suggests more of the same or only modest improvement. Following two years of strong growth, business capital spending declined about 1 percent in 1986. Investment in producers' durable equipment increased moderately, by about 4 percent, but this increase was more than offset by an estimated 12 percent decline for business structures (see Table I-8).

Although several special factors contributed to the weakness in capital spending in 1986, the current low rates of capacity utilization for existing capital constitute a general drag on further capital spending. Capacity utilization recovered sharply from the 1982 recession, from an

unusually low base, but then leveled off very early in the recovery at about 80 percent (see Figure I-14). In 1986, capacity utilization slipped to about 79 percent. Capital spending followed a similar pattern.

Two special situations contributed significantly to the weak spending on business structures. First, the drop in oil prices in early 1986 caused a sharp contraction in oil drilling--a major component of business structures (see Figure I-15). Investment in petroleum structures, which includes drilling, fell from an annual rate of $32 billion (in 1982 dollars) in the fourth quarter of 1985 to $18 billion in the third quarter of 1986. This one category accounted for about two-thirds of the overall decline in spending for business structures during that three-quarter period.

The other special situation involved the end of the boom in office building. Investment in office buildings increased more than 18 percent from the late 1970s, peaking in the second quarter of 1985. Despite very high and rising vacancy rates, the level of investment in office buildings remained high throughout 1985 and the first quarter of 1986. Earlier changes in tax laws were a major factor fueling the boom, particularly the rapid depreciation introduced with the Economic Recovery Tax Act of 1981. While the rate of depreciation permitted for tax purposes was reduced in 1982 and again in 1985, it remained considerably more rapid than it had been before 1981. The Tax Reform Act of 1986, however, substantially reduced rates for depreciation of structures and sharply curtailed other features of

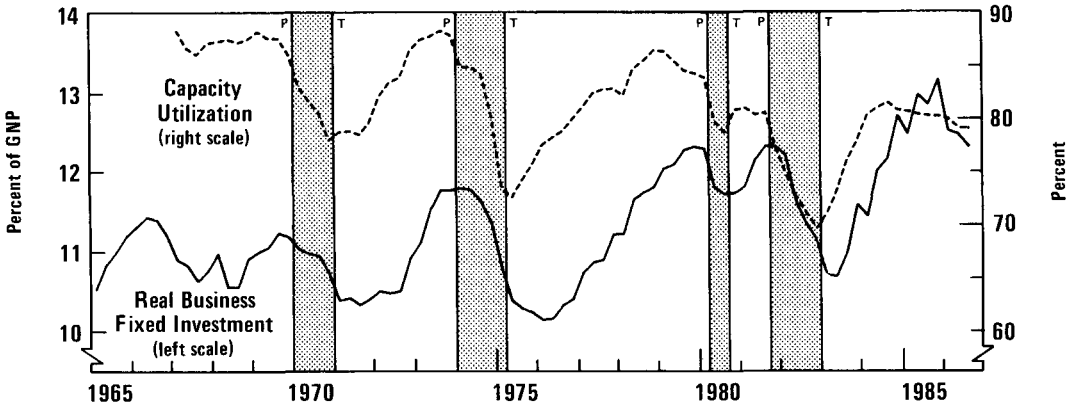
TABLE I-8. RECENT TRENDS IN REAL BUSINESS FIXED INVESTMENT (Percent change at annual rates)

	1983	1984	1985	1986 a/	1986 I	1986 II	1986 III
Total	-1.5	16.9	9.3	-1.1	-15.1	-0.9	-2.1
Producers' Durable Equipment	4.7	20.1	10.1	4.2	-17.0	19.6	1.2
Nonresidential Structures	-11.2	11.1	7.7	-11.8	-10.8	-35.2	-9.8

SOURCES: Congressional Budget Office; Department of Commerce, Bureau of Economic Analysis.

a. Estimated by CBO.

Figure I-14.
Real Business Fixed Investment



SOURCES: Congressional Budget Office; Department of Commerce, Bureau of Economic Analysis; Federal Reserve Board.

tax shelters for commercial real estate. These provisions took effect on January 1, 1987. Tax considerations spurred builders to attempt to finish projects on time to meet the deadline imposed by the change in tax law but discouraged the starting of new projects. 11/

The Outlook for Business Fixed Investment. The near-term outlook for business fixed investment is lackluster. On the positive side, most of the adverse effects on investment from the drop in oil prices should be over. The number of oil rigs in operation has increased steadily since mid-1986. There are numerous negative signs, however. One near-term bellwether--new orders for nondefense capital goods--has fluctuated within a rather narrow band for the last several quarters (see Table I-9). Another indicator, new capital appropriations of large manufacturing firms, declined sharply through the first three quarters of 1986. The rate of capacity utilization remains below 80 percent. Corporate profits and net cash flow have remained at fairly high levels during 1986, but the aggregate profit data mask weaknesses in several major manufacturing industries including petroleum and primary metals. Financial markets have provided some of the bright spots: the cost of borrowing, as measured by the rate on high-grade bonds, fell by about two percentage points during 1986 to a level

11. Investment in industrial structures was also quite weak in 1986, but this kind of building had not previously experienced a boom.

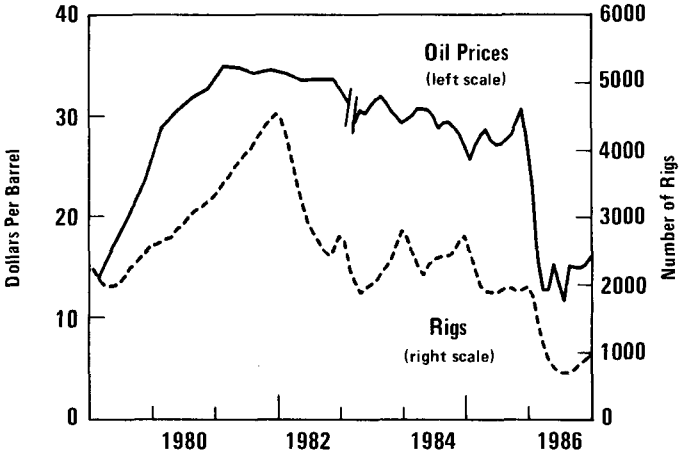
not seen for eight years. The stock market hit new daily highs early this year.

On balance, tax reform may have a negative impact on investment in 1987. Although passage of tax reform removes an important source of uncertainty for investors, a number of changes in business taxes tend to reduce incentives to invest. For example, as discussed earlier, many of the tax advantages from investing in commercial real estate were sharply curtailed on January 1, 1987. In addition, the investment tax credit for equipment was repealed (effective January 1, 1986), and allowable depreciation rates have been modestly reduced on most equipment. On the other hand, business investment spending would respond positively to any increase in personal consumption that may occur as a result of the cut in personal income taxes.

According to recent survey data of businesses' plans for capital spending, there may be little if any real growth in investment in 1987. The Commerce Department's survey shows that planned nominal spending is up only slightly over 1986 levels--a real increase of only 0.2 percent after adjusting for inflation (see Table I-9). The smaller survey conducted by McGraw-Hill indicates that businesses will reduce real outlays about 3.1 percent in 1987.

Though the average growth in business investment for 1987 will be low, investment should begin to recover by the end of the year. An acceleration of investment depends crucially on the behavior of net exports, however. If trade in manufactured goods does not improve substantially, little in the outlook would indicate an increase in investment spending.

Figure I-15.
Oil Prices and Oil Rigs in Operation



SOURCES: Congressional Budget Office; Central Intelligence Agency, Directorate of Intelligence; New York Mercantile Exchange; Hughes Tool Company.

NOTE: The price series is the official OPEC price (quarterly data) until 1983:I. The N.Y. Mercantile Exchange forward price for oil to be delivered in the next month is used thereafter.